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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, AN ARIZONA CORPORATION, FOR APPROVALS ASSOCIATED WITH A PROPOSED TRANSACTION WITH MARICOPA COUNTY MUNICIPAL WATER CONSERVATION DISTRICT NUMBER ONE TO ALLOW THE CONSTRUCTION OF A SURFACE WATER TREATMENT FACILITY KNOWN AS THE WHITE TANKS PROJECT	DOCKET NO. WS-01303A-05-0718 **ARIZONA-AMERICAN WATER COMPANY** **NOTICE OF FILING TESTIMONY SUMMARIES**

Arizona-American Water Company hereby files in the above-referenced matter testimony summaries for the following witnesses:

- Joseph E. Gross
- Thomas M. Broderick; and
- G. Troy Day.

RESPECTFULLY SUBMITTED on March 14, 2007.

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Summary – Testimony of Joseph E. Gross

In his Direct Testimony, Mr. Gross testifies as follows:

Mr. Gross first sponsors the following sections of the Revised Application.

- Page 3, line 15 – Page 8, line 13;
- Exhibit A; and
- Exhibit B.

A coalition of West Valley CAP contractors (WESTCAPS), including Arizona-American, produced a Regional Water Supply Plan in 2001, which recommended that an 80-mgd surface water treatment facility be constructed within Arizona-American's Agua Fria Water District to serve the District and surrounding communities. Arizona-American committed to take the lead in building and operating a regional treatment facility to provide potable water for its customers and for resale to other members of WESTCAPS. Arizona-American's 2003 Agua Fria Master Plan identified the project parameters and recommended that the Company begin plant construction. Capital funding was approved at the time for land acquisition and engineering design. Land was purchased, RFP's for design-build were solicited, a design-build team was awarded a contract, and design and permitting of the project began in late 2003. Extensive master planning efforts have taken place over the past four years to insure that the infrastructure necessary to distribute the plant's treated water will be in place in a timely manner. Black & Veatch, part of the original design-build team, finalized the White Tanks Plant design for bidding in November 2006.

For the White Tanks Plant, Arizona-American has spent over six million dollars to date for land acquisition, the completed design, permitting, company labor and overhead. Further, Arizona-American has spent over ten million dollars to date on the completed 13-mile north-south water transmission main, which will deliver the treated water from the White Tanks Plant to other transmission mains located throughout the Agua Fria Service Area.

The White Tanks Plant facilities consist of:

- Raw water facilities, including the intake structure, screening, storage basins, and pumping station.
- Water treatment facilities, including mixing, flocculation, dissolved air floatation (DAF) clarification, and filtration.
- Finished water and disinfection facilities, including Ultraviolet light disinfection, chlorination, storage basins and pumping station.
- Residual processing facilities, including DAF solids removal, filter backwash, filter-to-waste system, wastewater clarifiers, return flow pumping, and drying beds.
- Chemical feed and storage facilities.
- Emergency Generator to allow plant to operate in the event of a power outage.

The following schedule is updated from the one contained in Arizona-American's Revised Application:

- January 30, 2007 Construction Bids Received
- February 2007 Bid Analysis and Internal Approvals
- March 19, 2007 Commission Hearings
- May 8, 2007 Commission Open Meeting
- May 9, 2007 Notice to Proceed to Construction Contractor
- April 30, 2009 Plant In Service
- October 5, 2009 Final Project Completion

Mr. Gross estimates that the plant will cost $59.4 million. The plant consists of three process trains of 6.67 mgd each, for a total capacity of 20 mgd. Utilizing common engineering practice, the reliable capacity of the plant would be rated at 13.4 mgd, assuming one train is not in service, either during a backwash cycle or when undergoing media replacement or maintenance. Expansion to a reliable capacity of 20 mgd would only require construction of one additional 6.67-mgd process train. This would bring gross capacity to 26.7 mgd, with a firm capacity rating of 20 mgd. The completed plant design includes space for adding another process train. If a third party could commit by the end of 2007 to using or purchasing sufficient capacity to warrant the expansion, the cost to add one additional 6.67-mgd process train would be approximately two million dollars. This would significantly reduce the White Tanks Plant's per-mgd capacity cost.

Considerable process and project management expertise exists today within American Water's staff in Arizona and at corporate level. The design project manager since the beginning of this project is still on board. He understands the rationale for each aspect of the selected treatment processes and will continue to oversee any design issues needing clarification during construction. American Water's senior construction management person has also tracked this project from the beginning, providing cost-effective constructability reviews and comments. He is currently relocating to Arizona to be the full-time construction manager for this project. Additionally, Mr. Gross has significant experience with major water treatment projects in Scottsdale and will be closely involved in any management-level decisions needed to keep this project on track.

Arizona-American currently owns, maintains, and operates the 7-mgd CAP water treatment plant that supplies treated water to the Anthem community. On February 26, 2007, we began operations for the 3 mgd Cave Creek CAP water treatment plant. Further, we own and operate eight new arsenic treatment facilities in Arizona.

An Arizona-American affiliate (American Water Enterprises) managed construction of the City of Phoenix' brand new 80-mgd CAP water treatment plant and will also operate the plant for the City. This plant is ultimately expandable to 320 mgd. American Water's regulated companies currently operate 79 surface water treatment plants, with a combined treatment capacity of over 1390 million gallons per day. As the owner of these facilities, American Water is involved in all

aspects of plant operation, including treating water to meet or surpass required standards, and the repair and replacement of all equipment.

Mr. Gross next responds to the testimony of MWD witness James Albu. He has eleven major concerns with this testimony:

a. The MWD plant has not yet been designed. Without a reasonably final design and approved permitting, it is very difficult, if not impossible, to accurately estimate a project's cost or schedule. At this point, all MWD has is a brief preliminary engineering study.

b. The MWD cost "estimate' is seriously flawed. MWD's costs are estimates made prior to even a conceptual design for the MWD plant. Apparent problems with the cost estimates include:
   - No inflation to future years until actual construction.
   - Assumption of no changes to the project concept during design or construction.
   - Abnormally low construction estimate, if contingencies are included, as stated.
   - No land value, currently appraised at $115,000 per acre, is charged.
   - No construction financing costs are included.
   - Only $8 million in engineering and construction administration costs are included, compared to $14.4 million estimated for same services in the Malcolm Pirnie Final Report of the MWD Water Treatment Plant Planning: Preliminary Engineering Study. ("Preliminary Engineering Study").

c. The MWD plant would only be able to provide 10 mgd of firm capacity. The MWD Treatment Plant would consist of two 10-mgd treatment trains. Utilizing common engineering practice, the reliable capacity of the plant would be rated at just 10 mgd, assuming one clarification train is not in service, due to an unscheduled outage or maintenance requirements. If 20 mgd of capacity were committed equally to two parties and one train went out of service, each party would be left with just 5 mgd of treatment capacity. Losing 5 mgd of an important resource on a hot summer day could certainly present problems for each of the buyers. Further, if MWD actually expects to sell firm capacity, the final design will have to include a back-up treatment train, which is further evidence that MWD's preliminary cost estimate is flawed.

d. The MWD schedule is unreasonably optimistic. The MWD schedule is unreliable because of the conceptual nature of the MWD proposed plant. Without a reasonably final design, it is difficult at best to estimate how long it would take to construct the facility. Further, the Preliminary Engineering Study identifies a number of issues that will need to be addressed before finalizing site selection. Further, MWD has no customers for a plant and has not decided whether to construct a 10-mgd or 20-mgd plant. One significant scheduling error is the Preliminary Engineering Study's assumption that permitting can begin prior to the start of detailed design and be completed prior to design completion. Permit applications are normally not considered by regulatory agencies prior to 90% completion of plans. Also, Maricopa County normally takes six to eight months to process a Special Use Permit. Then, a County Building Permit is normally not issued for

approximately 30 days after approval of the Special Use Permit by the County Board of Supervisors.

e. The MWD plant site would require Arizona-American to construct additional, expensive, transmission facilities. Significant additional costs in transmission system routing would be required if the plant location was changed. The Arizona-American master plan is based on our main water transmission line being routed along Cactus Road to two major booster pump stations. A plant at the proposed MWD site, over two miles south of Cactus Road, would require redundant pipelines to bring the water back north to the Cactus Road alignment. Additional booster pumps may also be required to move the water uphill. A large transmission main to bring the water north to Cactus Road would likely cost in excess of $6 million in construction costs, if aligned along the Beardsley Canal.

f. Arizona-American would not be the operator of the MWD plant. Arizona-American's Plant design incorporates a centralized instrumentation and control system at the White Tanks Plant, which would also communicate with all the groundwater plants in the Agua Fria service area. This allows Arizona-American to dispatch the Plant's output in coordination with our transmission system and with groundwater production needed to meet peak demands in summer and during canal outages. Managing a coordinated water production, transmission, and distribution system in a geographic area as large as our Agua Fria Water District requires significant expertise and relies on years of institutional knowledge. Arizona-American does not believe that ceding operational control of the regional water plant would be wise, particularly coupled with relocating the instrumentation system needed to coordinate MWD's plant's output with our integrated system. At best, this would require extensive training, operating protocols, and additional equipment expense. At worst, our customer' reliable water deliveries could be jeopardized.

g. MWD cannot provide back-up well water in a timely manner. Despite its claim, MWD cannot provide back-up water in the event of a plant outage. MWD's wells are irrigation wells. In order to supply water to treatment plant customers, several lengthy, costly steps would have to be taken—at the customer's expense. First, irrigation wells would have to be identified that would not require additional treatment, other than chlorination. Arsenic, nitrate, and fluoride levels are not issues for irrigation wells, but are critically important for potable water wells. Second, after a potential candidate well was identified, it would have to be equipped with a sanitary steel casing, automated with instrumentation and controls, upgraded with a new pump and motor capable of meeting distribution line pressures, and provided with a tank for chlorine contact time. Only then could the well provide drinking water for customers. Based on our recent experience with converting one MWD well to a potable water well, it would take 6 - 8 months to identify, permit, and convert one of MWD's irrigation wells to a potable-water well. Additional pipeline connections would then need to be constructed to get the water from the converted well to the customer's delivery system. Repairing or rebuilding a facility in the event of a catastrophic outage would likely take less time than identifying, permitting, and converting a suitable number of MWD wells to replace treatment capacity during the outage.

h. The MWD plant site would eventually require costly expansion of the Beardsley Canal. In the Preliminary Engineering Study, page 3-2, Malcolm Pirnie states: "canal capacity south of Cactus Road is 50 mgd and will need to be increased if the capacity of the [Water Treatment Plant] exceeds 50 mgd." MWD's proposed plant site is south of Cactus Road. This means that MWD will have to expand the canal, which would be a costly, time consuming process, in order to increase the plant's capacity to over 50 mgd. By contrast, Arizona-American acquired its site north of Cactus Road, so it will not be necessary to expand the Beardsley Canal to increase plant capacity up to 80 mgd.

i. MWD has no experience in designing, constructing, or operating major potable water treatment facilities.

j. MWD has no customers for the MWD plant. MWD has not committed to build a plant without having first completed contracts with customers for the capacity.

k. MWD has no obligation to construct a treatment plant. If MWD were unable to finalize contracts for sufficient capacity to justify building a treatment plant, it could just decide to focus its efforts in another direction. By contrast, Arizona-American has identified its own need for its White Tanks Plant and does not require capacity commitments from any other party to proceed. As soon as the Commission approves increasing hook-up fees to a level sufficient to proceed, Arizona-American will award the bid and construction will commence shortly afterward.

In his <u>Surrebuttal Testimony</u>, Mr. Gross testifies as follows:

Exhibit A in Arizona-American's Revised Application has been superseded by the cost estimate set forth in his direct testimony. That estimate is based on actual costs to date and the firm bids that Arizona-American has received from four contractors. As such, this is far more accurate than the estimate contained in Exhibit A, which should now be disregarded.

If Arizona-American were to build a plant with 20 mgd of firm capacity, it would cost approximately $61.4 million in 2009. This cost is virtually identical to MWD's $60 million preliminary estimate for its proposed 20-mgd treatment plant, based upon their costs escalated to 2009.

MWD's $60 million preliminary estimate is valuable only as a rough check for the expected cost of Arizona-American's White Tanks Plant. MWD did not address the issue of total capacity versus firm capacity. An Arizona-American 20-mgd plant would actually include four 6.7 mgd treatment trains, which would allow the Company to provide 20 mgd of firm treatment capacity, even when one train is out of service. By contrast, when one train is out of service at the proposed MWD facility, the plant would only be able to provide 10 mgd of capacity. Also, Arizona-American's plant cost estimate is based on actual bids that the Company has received, and includes land costs. MWD's "estimate" is based on a preliminary design study, and land costs still need to be added to the plant cost. Further, Arizona-American will not have to build additional interconnection facilities in addition to those currently planned, but new interconnection facilities would be needed if Arizona-American were to buy treatment capacity

from MWD. Finally, delaying the availability of treatment capacity until 2011 or later is just not a good option.

Arizona-American has received four bids from contractors who wish to build the White Tanks Plant. By the terms of the Invitations for Bid, these bids are firm until approximately May 1, 2007. Arizona-American cannot award the bid until the Commission approves its application. As a consequence, if Commission approval is delayed significantly past May 1, it is probable that one or more bidders would no longer be available, and/or that construction costs could increase.

If the White Tanks Plant is not operational in 2009, Arizona-American may have to construct a 3.5 mile pipeline along the Cotton Lane alignment, from Paradise Lane to Cactus Road, then west to Citrus. This would allow Arizona-American to transfer additional groundwater from wells in the northern portion of the service area to the southern portion, where demand continues to increase. The total cost of this pipeline is budgeted at over $6 million.

Summary – Testimony of Thomas M. Broderick

In his Direct Testimony, Mr. Broderick testifies as follows:

Mr. Broderick first sponsors the following sections of the Revised Application.

- Page 1, line 1 – Page 3, line 14;
- Page 8, line 14 – Page 13 line 18;
- Exhibit C;
- Exhibit D; and
- Exhibit E.

Mr. Broderick next discusses Arizona-American's requests in this case. We ask that the Commission:

1. Increase the Water Facilities Hook-Up Fees applicable in the Company's Agua Fria Water District in accordance with one of two options.
2. Issue an Accounting Order to keep Arizona-American whole on the excess of capital expenses above hook-up fees.
3. Order Arizona-American to file, as part of its 2008 Agua Fria Rate Filing, a revised Water Facilities Hook-Up Fee proposal based on the best information known at that time.
4. Order Arizona-American to file, as part of its 2008 Agua Fria Rate Filing, for approval of a proposed mechanism, similar to the Commission's ACRM procedure, to defer and subsequently recover operation and maintenance expense for the White Tanks Plant incurred until such expenses can be placed in base rates.

In response to intervenor testimony in this case, the Company is now also asking the Commission to:

5. Approve a formula to reduce the Water Facilities Hook-Up Fees in the event Arizona-American is able to either:
    a. Sell a share of the White Tanks Plant to a third party; and/or
    b. Execute a long-term contract with a third party for a share of the White Tanks Plant.

Mr. Broderick next discusses hook-up fees. In its Agua Fria District, Arizona-American is currently charging homebuilders a Water Facilities Hook-Up Fee of only $1,150 for 5/8 x 3/4-inch meters, $1,750 for 3/4-inch meters, $2,875 for one-inch meters, and so forth for larger meters. This is substantially less than builders are now paying in similarly growing areas in Maricopa County

For Option 1, Arizona-American proposes to increase its hook-up fee to the same level as the rate-base reduction fee in effect for its Anthem Water District, which begins at $3,000 for a 5/8 x ¾ inch meter. At these levels, the White Tanks Plant would be fully funded in late 2013 based on current forecasts.

For Option 2 Arizona-American proposes to reset the Water Facilities Hook-Up Fees to levels anticipated to be sufficient to fund the White Tanks Plant in the year it enters service – 2009. This hook-up fee would start at $4,700 for a 5/8 x 3/4-inch meter.

Mr. Broderick next discusses what the Company is asking for in an accounting order.

First, the order should provide Arizona-American the ability to accrue post-in-service AFUDC on the unfunded balance of the White Tanks Plant investment. This will keep Arizona-American whole on its investment until accumulated hook-up fees are sufficient to fund the entire Plant balance. Even with Option 2, there is an expected shortage at plant completion between capital expenses and accumulated hook-up fees. And if growth is less than expected, this shortage would be larger and last longer. The additional post-in-service AFUDC would later be completely offset by hook up fees.

Second, the order should provide that collected hook-up fees will not be considered to be contributions for ratemaking purposes until some corresponding eligible plant enters service. Because CWIP is not typically included in rate base, the contribution balance would otherwise grow far faster than rate base, thereby causing rate base to decline significantly in the next rate case, only to then bounce back as the plant entered service.

Mr. Broderick next discusses two other things that Arizona-American is asking the Commission to order concerning its planned May 2008 rate filing.

First, order Arizona-American to propose to adjust the Water Facilities Hook-Up Fees based on information known to that date including:

- Actual to-date and remaining plant costs;
- The effects of any third-party treatment contracts;
- Actual hook-up fee collections;
- Revised projected customer additions and meter preferences; and
- Future Agua Fria district capital requirements.

Second, order Arizona-American to propose a mechanism, similar to the Commission's ACRM procedure, to defer and subsequently recover operation and maintenance costs associated with the White Tanks Plant until such expenses can be included in base rates. The Company estimates that these O&M costs will be approximately $1.5 million per year, based on current media, electricity, and other costs.

At the end of this section of his testimony, Mr. Broderick discusses Arizona-American's new fifth request – that the Commission approve a formula to reduce the water facilities hook-up fees if the Company sells or otherwise commits White Tanks Capacity. Mr. Broderick explains the formula and provides a numerical example.

Mr. Broderick next discusses the October 27, 2006, Staff Report in this docket and states that Arizona-American accepts the recommendations made by Staff.

In the next section of his testimony, Mr. Broderick responds to the testimony of MWD witness James Sweeney.

First, he assures the Commission that Arizona-American, as part of the largest private water company in the United States will be able to obtain financing for the White Tanks Plant, despite recent disappointing Arizona financial results. However, this will require reducing regulatory lags by funding the project with hook-up fees. The Commission has approved similar mechanisms at lease three other times for Arizona-American in the recent past.

Arizona-American's proposal would not require a rate increase, in contrast to purchasing capacity from an MWD-owned facility, which would cause a rate increase. Purchasing capacity from MWD would also further degrade Arizona-American's financial health.

Mr. Broderick next turns to MWD's idea of a landowner credit through Arizona-American's bills. He explained that MWD would have to provide much more detail before he could adequately respond to it.

In the next section of his testimony Mr. Broderick provides details of Arizona-American's offer to sell up to 10 mgd of plant capacity to MGD or another party, such as an investor-owned utility or a municipal water utility. The White Tanks Plant is designed to easily accommodate an additional 6.5 mgd filter train, which would bring total, firm capacity to 20 mgd. Capital costs, whether sunk or ongoing, would be shared in proportion to ownership shares. Fixed O&M costs would also be split in proportion to ownership shares. Variable O&M costs would be split in proportion to monthly usage. Arizona-American will operate the White Tanks Plant in coordination with Arizona-American's other water production, transmission, and distribution facilities.

Mr. Broderick concludes by addressing various concerns raised by developers in their testimony

Developers were concerned with plant delay. Arizona-American should be able to put the White Tanks Plant into service in mid 2009, most likely two years before MWD could put a treatment plant into service.

Developers also expressed concern with the size of the proposed hook-up fees. As demonstrated in Arizona-American's Revised Application and in Mr. Brilz' testimony on behalf of Pulte Homes, this fee would not be out of line with hook-up or impact fees charged by West Valley municipal water providers. Further, the Commission recently approved a rate-base reduction tariff for Arizona-American's Anthem Water District, which applies to all new connections and starts at $3,000 for 5/8 x 3/4-inch meters. The Anthem rate-base reduction tariff is on top of a $765 per equivalent residential unit capacity reservation charge. Further, the hook-up fee could go down in two circumstances. First, as discussed above, Arizona-American is asking the Commission to approve a formula to automatically reduce the Agua Fria Water Facilities Hook-Up Fee when a party irrevocably commits to purchase capacity or signs a long-term, take-or-pay

treatment contract that allows Arizona-American to recover its capital costs associated with the associated capacity. This formula would be incorporated into the tariff and be applied shortly after a filing providing the details of the sale/commitment. Second, Arizona-American has agreed to update the hook-up fee assumptions as part of its 2008 rate filing, so that the Commission can make any necessary adjustments to the hook-up fee amounts.

Developers were also concerned about when the hook-up fee increase should be applied. Arizona-American believes that the new hook-up fee should be applicable if the tariff is effective prior to operational acceptance under the terms of line extension agreements. This is equivalent to the meter-set date. This is exactly how a similar tariff in Anthem is applied.

In his Surrebuttal Testimony, Mr. Broderick testifies as follows:

MWD did not estimate the rate impact of its proposal. However, Arizona-American was able to obtain through a data request the majority of the information that was needed to complete an analysis. Based on his analysis, Mr. Broderick concluded that **the average Agua Fria Water District customer would pay an additional $21.07 per month if Arizona-American were to purchase treatment services from MWD**.

The average residential customer bill in Arizona-American's Agua Fria Water District is presently $26.64/month, including the ACRM surcharge. Based on this rate, **the average residential increase would be 79 percent**.

MWD's proposal would require all customers, existing and future to pay for the cost of the treatment plant. Because it is customer growth that largely drives the need for the plant, it is more equitable for these new customers to pay for the plant through increased hook-up fees for new construction, than for existing customers to be saddled with a large rate increase.

Purchasing capacity from MWD would also erode Arizona-American's financial strength. If Arizona-American were to purchase capacity from MWD and construct additional facilities needed to make the purchase possible, it would have to file a rate application in order to recover the increased costs. Because of normal regulatory lag, Arizona-American would incur at least a year's worth of costs, without compensation. As shown on Exhibit TMB-S1, that would reduce operating income by over $7 million. Arizona-American is not in a position to incur costs of this magnitude without recovery.

It is quite possible that a capacity commitment for a large portion of the MWD plant would require that the agreement be treated as a capital lease. This would require that a lease asset also be included in rate base, with rates set to recover the asset.

For these reasons, it seems unlikely that Arizona-American could obtain approval for purchasing treatment capacity from MWD.

Summary – Testimony of G. Troy Day

In his Direct Testimony, Mr. Day testifies as follows:

Arizona-American has developed a Master Plan for providing long-term water service in its Agua Fria Water Certificate of Convenience and Necessity "(CC&N)." Each developer must execute a line extension agreement ("LXA"), which governs exactly which water facilities a developer must construct before receiving water service. Each LXA includes exhibits, which detail all required water distribution, supply, storage, and transmission facilities for the new development.

When Arizona-American determines that the increased demand associated with the development will exceed what Arizona-American can supply to the area, it will require the developer to provide enough water, typically from new wells, to meet the incremental demand. If the water quality and quantity meets the standards set forth in the LXA, Arizona-American accepts the well and the developer deeds the well to Arizona-American. If the developer cannot provide acceptable water supplies, then Arizona-American will not set new meters until the developer can live up to its obligation under the LXA. This protects existing water customers from a future water shortage caused by new customers' demand.

Actual well delivery quantities may be disappointing. Further, water quality may be unacceptable without, or even with, expensive treatment. In these cases Arizona-American has been forced to postpone setting water meters until the developer can provide the required water necessary to meet the demand of their development. As the District has developed toward the south and west, new well yields and water quality have been inconsistent and disappointing. It is getting more difficult and expensive for developers to provide ground water to support their developments.

It is unlikely that Arizona-American would have to actually go to the Commission to request a moratorium. If Arizona-American continues to vigorously enforce its LXAs, we should be able to avoid that last resort. If a developer can provide the required water, Arizona-American will continue to set meters and take on new customers in the development. However, if the water supplies are not delivered, Arizona-American will continue to refuse to set meters until the supplies are deliver. The ability to provide adequate water resources is becoming more difficult and more expensive.

Arizona-American will still need well supplies, even after a regional treatment facility comes on line. We must be able to supply our customers, even if the plant is off-line, whether during planned or unexpected outages. Wells are also necessary to meet peak demands in the high use summer months. Further, Arizona-American's CAP allotment is only part of our overall resource portfolio, and cannot be delivered everywhere in the Agua Fria District. Well supplies will continue to be needed. However, fewer wells will be needed from developers once the White Tanks Plant is on line.

As the Agua Fria District builds out, Arizona-American will need to obtain additional surface water supplies, as well as additional well-water supplies.